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## Summary

¶1. (SBU) Mauricio Choussy, Managing Director of Fitch ratings for Central America, Belize and Panama, is optimistic about export growth and inflation, but pessimistic about the Government of El Salvador's (GOES) fiscal situation because of the spiraling cost of inefficient subsidies. He fears a Central American liquidity crunch that could be exacerbated by a victory by the leftist FMLN in January 2009 legislative elections, but forecasted an ARENA victory in the March 2009 presidential election. End summary.

## The Positive: Export Growth, Low Inflation

¶2. (U) On July 14, Econoff discussed the overall Salvadoran economic situation with Mauricio Choussy, the Managing Director of Fitch ratings for Central America, Belize and Panama, (and former Central Bank President during the Duarte administration). As a risk analyst, Choussy said his job was mostly about seeing the negative, but he did see a few bright spots. First, though rising significantly above what it has been in the last several years (9% annual rate through June 2008), El Salvador's inflation rate remains one of the lowest in Latin America. Second, for the first time in several years, in April 2008 exports grew more than imports.

¶3. (SBU) Contrary to most other Salvadoran analysts, Choussy did not view rising food prices as a major economic problem. Instead, he thought it offered a real opportunity to make inroads against chronic unemployment and underemployment in rural areas.

## Problematic Subsidies

¶4. (SBU) Choussy identified inefficient government subsidies as a major fiscal problem. First, the subsidies, especially for propane gas, electricity, and transportation, are not properly targeted, going to rich and poor alike; Choussy said he personally received propane and electricity subsidies. Second, the amount of the subsidies depends on the commodity price, making it almost impossible for the GOES to budget. Choussy doubted that the GOES would be able to pay all its subsidies on time. Finally, the method for paying the subsidies is poorly designed. Choussy noted that, for transportation, the subsidies were given per bus regardless of passengers, so some of the transport companies had started running empty buses.

¶5. (SBU) The electricity subsidies were particularly problematic, especially the debts owed by the state-owned hydropower authority (CEL). Choussy estimated CEL would ultimately need to pay about $400 million in the next year. He said that CEL had originally hoped to fund its debts by securitizing 25% of its generating

capacity on the stock market, but as its debts continue to rise, it has had to abandon that plan. Instead, CEL would likely have to raise new external debt through a trust, which lacked of financial transparency. (NOTE. On July 22, the GOES announced that it would phase out the subsidy for industrial users. Details reported septel. END NOTE.)

¶6. (SBU) Local electric companies were now having problems managing their cash flow. With tariffs artificially set by the government, CEL unable to pay subsidies on time, and banks unwilling to lend to them, the electric companies were no longer able to manage their cash flows and also maintain service. This had lead Fitch to downgrade U.S.-owned electricity distributor AES.

¶7. (SBU) In Choussy's view, an underlying problem is that the Saca Administration refuses to speak honestly about the economy. The rest of Central America is facing similar problems, he said, especially rising energy prices, but the difference was that their leaders acknowledging that difficult times lay ahead. The Saca Administration, in contrast, was continuing to issue "rosy growth projections" and saying that "everything is fine." He particularly faulted the current budget, since in an election year spending will always be higher than projected, but the GOES did not plan for a deficit.

¶8. (SBU) Choussy also criticized the recently approved $0.04 tax on incoming international phone calls, calling it a tariff barrier to foreign services and a possible CAFTA-DR violation. President Saca is in favor of the tax, but has not yet signed the legislation.

LIQUIDITY CRUNCH?



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¶9. (SBU) Choussy's main preoccupation about the Salvadoran economy in 2009 was a potential "liquidity crunch." While the Salvadoran financial sector is now entirely owned by international banks, those banks are having economic problems in their home countries. In his view, the international banks will be focused on trying to make the most profitable loans with the least amount of risk, and would therefore avoid El Salvador. At the same time, he added, sovereign wealth funds "aren't interested" in investing in El Salvador. That leaves local deposits to fund new loans, and he was concerned that bank deposits had decreased around $200 million between March and April. As credit availability declines, Choussy expected interest rates to rise. He added that liquidity is a potential problem in all Central America, not just El Salvador.

¶10. (SBU) Choussy's worst-case liquidity scenario is a large FMLN victory in the January 2009 municipal and legislative elections, with uncertainty about the outcome of the March 2009 presidential elections. In a dollarized economy, he noted, capital doesn't need to leave the country - people can just pull money out of the banks and stuff it in their mattresses -- and the political uncertainty could lead to a run on the banks. He said this worst-case scenario could be like "Panama under Noriega," where so much money was taken out of circulation that there wasn't enough for even basic economic transactions.

ELECTION OUTLOOK
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¶11. (SBU) Choussy forecasted an FMLN victory in the legislative elections, but an ARENA victory in the presidential race, despite their current poor showing in the polls. He thought ARENA's "feud with the private sector" was coming to an end, which would let them finally focus their attention on the FMLN. Ultimately, he said, a campaign based on the "fear factor" of total FMLN control of government should be enough to sway the election to ARENA.

COMMENT
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¶12. (SBU) Choussy is a keen observer of the Salvadoran economy,

though a pessimist by both nature and occupation. He was pessimistic about the Saca Administration's ability to handle the current economic situation in El Salvador. While he did not tip his hand on any future ratings changes, new Fitch reports are likely to be negative. Nevertheless, Choussy tries to keep a long-term perspective; despite frequent bad news, he said, "things aren't as bad now as they were in 1988." In fact conditions are not as bleak as they could be, especially given the economic slowdown in the USA, El Salvador's largest trading partner. Respected think tank FUSADES recently lowered its projection for 2008 GDP growth rate to 3.8%. Still, that rate of growth is nearly double the annual economic growth El Salvador had experienced in the decade leading up to the 2006 implementation of CAFTA-DR.

Glazer